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Basic Problems of Harmonizing Tax Law in the European Communities

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Table of Contents

1. Introduction - Review of EEC tax developments

The EEC has recently established highlights on coordinating the European tax systems.

Indirect taxation, VAT as well as excise duties are subject to political agreements on the harmonization in the EEC after 1992. Customs have already been uniform since 25 years.

The Commission's new approach on direct tax developments seeks the mutual coordination and approximation of national tax policies by the Member States.

In Germany, these policies of the EEC are related to 706,730 billion Deutschmarks tax yield levied from 3001,0 billion Deutschmarks Gross National Product - GNP - estimated for 1992.[1]

2. Requirements of the Treaty of Rome

The Treaty of Rome sets out to create a single market within the European Economic Community. To achieve this, the contracting parties of the Treaty of Rome agreed on

- the abolition of obstacles to the free movement of persons, services and capital,
- the right of establishment of nationals of a Member State in the territory of another Member State,
- the establishment of a system ensuring that competetion in the Common Market is not distorted, and
- the approximation of the laws of Member States to the extent required for the proper functioning of the Common Market (Art. 3 of the Treaty of Rome - "Treaty").

The Treaty explicitly deals with indirect taxes, outlawing not only customs duties and export subsidies, but other indirect tax measures which would have equivalent effects (Art. 95 to 99 of the Treaty).

In the light of the completion of the internal market without frontiers and without physical frontier controls, comprising free movement of goods, persons, services and capital and the

1 Finanzbericht 1992, Published by the Bundesministerium der Finanzen - Finanzbericht 1992 -, p. 84, 94, 217.

freedom of establishment of nationals in the territories of another Member State - the four European freedoms -, the harmonization of indirect taxes is evidently an absolutely necessary condition to achieve these objectives.[2]

The above quoted provisions, Art. 52 of the Treaty on the Right of the Establishment of Enterprises in other Member States and Art. 100 of the Treaty on the approximation of legislative and administrative provisions of the Member States, which have a direct influence on the establishment and functioning of the Common Market, can be interpreted as requiring harmonization of direct tax systems as well; even though, the Treaty did not concretely and comprehensively deal with obstacles to the creation of a single market caused by direct taxation. Even the provision of Art. 220 of the Treaty of Rome dealing with abolition of double taxation was not a prohibition; it was prefaced with:

> "Member States shall, as far as necessary, enter into negotiations with each other..."

Nevertheless, the legal basis on harmonization or only coordination of enterprise taxation in the EEC is rather weak. Unlike the indirect taxes - which include in particular the value added tax -, none of the articles provides specifically for a harmonization of direct taxation.[3]

The Commission decided to give priority to measures required to eliminate or reduce obstacles to cross-border activities by 1993, an approach which accords with the Principle of Subsidiarity; policies should be forged at the most local level which is feasible. Clearly, the feasibility of implementing a policy at the local level is closely related to the magnitude of any interjurisdictional spillover effect associated with it.[4]

The Member States amended the Treaty in 1986 implementing Art. 100 (a). As to its Para. 1, the Council will pass directives and administrative provisions with a qualified majority to complete the internal market without frontiers on December 31, 1992; the unanimous consent of the Council, however, is required for the harmonization or even coordination of tax matters.

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2 Wägenbaur, in: Grabitz, Kommentar zum EWG-Vertrag, Art. 99, Note 2 and 3.

3 On the harmonization of direct taxes reference is made to Gert Sass, Probleme der direkten Steuern in der Perspektive des gemeinsamen Binnenmarktes, Vorträge, Reden und Berichte aus dem Europa-Institut der Universität des Saarlandes, Nr. 147, 1988; and Georg Ress, Überlegungen zur Zulässigkeit und zu den Grenzen europäischer Steuerharmonisierung, in: Die Europäische Wirtschaftsgemeinschaft auf dem Weg zum einheitlichen Binnenmarkt und zur Steuergemeinschaft im Jahr 1992, Vorträge, Reden und Berichte aus dem Europa-Institut der Universität des Saarlandes, Nr. 146, 1988, p. 9 et seq.

4 Scrivener, Harmonization of Tax Law within the Community, European Taxation 1990, p. 355, 356; report of the Committee of Independent Experts on Company Taxation, 1992, p. 24 - "Ruding Report".

3. Excise Duties and VAT

The coordination of indirect tax systems is provided for by rather precise requirements of the Treaty.

The EEC and the Member States have passed resolutions and agreements on abolishing frontier controls on goods subject to excise duties or VAT.

3.1 Excise Duties

In September 1990, the EEC Commission introduced proposals on excise duties which are designed to introduce a system of interlinked bonded warehouses and provide a harmonized definition of how excise duties should apply to alcohol, tobacco and mineral oils.[5]

Germany levies excise duties on many goods. The yield from excise duties is material, however, when levied on alcohol, tobacco and mineral oils 10 Pfennigs increase of the excise duty on gasoline contributes with 4 billion Deutschmarks to the Federal Budget. In 1992, the revenues of the government from excise duties shall achieve

- on tobacco 20,2 billion Deutschmarks,
- on alcohol (beer included) 7,6 billion Deutschmarks, and
- on mineral oil 54,2 billion Deutschmarks.[6]

Alcohol, tobacco and mineral oils would as of January 1, 1993 be able to circulate free of duty throughout the EEC. Duties would only have to be paid in the importing country when the product enters the retail system.

Three Directives provide the technical definitions for each category or structure of goods subject to duties. The Commission has decided against too rigid harmonization of excise duty structures and has, instead, opted for a minimum level of regulation.

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5 Howard M. Liebman/Russell M. Patten, Review of EC Tax Developments, European Taxation 1991, p. 364, 369.

6 Finanzbericht 1992, p. 211.

The first Directive concerning the structure of excise duties on alcoholic beverages and on alcohol contained in other products, provides for the duty on such products to be calculated per hectolitre of pure alcohol at 20° C, based on the number of hectolitres of alcohol available to consumers.[7]

The second Directive concerning the structure of excise duties on tobacco provides that duties will reflect the basic retail price, including all taxes and VAT.[8]

The third Directive concerning the structure of excise duties on mineral oils, stipulates that mineral oils used as fuels are to be subject to excise duties calculated for 1,000 litres at a temperature of 15° C. However, two types of exemptions are proposed:

- Member States will not be compelled to exempt mineral oils used for non-fuel purposes, gas oil used for railway locomotives and fuels used for commercial air- and seatransport.

- Member States will be responsible as to whether or not to allow to a duty-free concession or a lower rate of duty for mineral oils used for the production of electricity, farming and in the public transport sector.[9]

The Commission is still considering standard rates of excise duties to be set equal to a minimum rate.[10]

3.2 Value-added Tax

The value-added tax - VAT - was established through several Directives enacted 1967.

- Taxable persons are all entrepreneurs , including persons carrying on business in agriculture or exercising a liberal profession, and importers.

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7 EC Council Directive (Proposal), Official Journal No. C 322 of December 21, 1990, p. 11.

8 EC Council Directive (Proposal), Official Journal No. C 322 of December 21, 1990, p. 16.

9 EC Council Directive (Proposal), Official Journal No. C 322 of December 21, 1990, p. 18.

10 Scrivener, Harmonization of Tax Law within the Community, European Taxation 1990, p. 355, 357; Van Thiel, Removal of Indirect Tax Barriers to a Single European Market, VAT Monitor 1990, pp. 17, 19; Vanghel, Die Harmonisierung der besonderen Verbrauchssteuern im Rahmen des EWG-Vertrages, 1990, p. 74 et seq.

- The taxable base is the consideration for goods supplied and services rendered. For imported goods, the taxable base is the value of importation, including customs duties and expenses; for imports from EEC-countries, no customs duties are imposed.

- Exports are exempt from tax for reasons of the "destination principle"; the importing Member State levies its VAT on such imported goods so that they carry the same VAT burden as goods from national origin.

- In computing the final tax liability, the "input-tax" for goods and services received from another entrepreneur and paid to him as an element of his bill, may be deducted by the entrepreneur or refunded by the tax administration, so that in effect, only the value added is taxed.

- The general rate is 14 %, while the reduced rate amounts to 7 %.

The yield from VAT is estimated by 195,6 billion Deutschmarks in Germany for 1992, which is essential for the budget. By virtue of the 1992 Tax amendment Law, the general rate will be increased to 15 % as of January 1, 1993.[11]

Member States importing goods from other Member States controlled such imports at intra-community borders.

After 1993, such fiscal borders have to be removed, based upon different Directives proposed by the EEC Commission and passed through the Council.

The overall impact will be to push down VAT-rates in the EEC as a whole, although Luxembourg and Spain will have to raise their standard VAT-rate by 3 %.[12]

The VAT-rates differ from country to country. The Commission and the Council did not reach the necessary consent on uniform, standard rates applicable in each of the Member States. The Commission opted for a minimum level of regulations; the Commission set a standard rate of VAT equal or higher than 5 %. This regime will become effective as of

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11 1992 Tax Amendment Law of February 25, 1992 BGBl. I 1992, 297.

12 The rates applied at present are listed in Attachment 1, 1992 International Bureau of Fiscal Documentation, European Communities, Section A, No. 3/4 of March 1992.

January 1, 1993.[13] As mentioned above, Germany has passed a legislation increasing the standard rate of VAT up to 15 %, which will become effective as of January 1, 1993.

After 1996, the export of goods from one Member State to another Member State will be taxed following the principle of origin. Such exports will no longer be VAT-exempt. The national VAT of the country of origin may be credited as input tax against the national tax burden of the importing entrepreneur.

These structures of the VAT should be achieved no later than 1997. Meanwhile, the VAT will be governded by a transitional regime.[14]

- As of January 1, 1993 through December 31, 1996 certain transitional VAT-arrangements will apply where by all tax checks and formalities at intra-community borders would be abolished. Exports will remain tax exempt, and the payment of VAT would be maintained as at present, in the country of destination however.

- After December 31, 1996, VAT will be paid in the Member State, in which goods originate.

- In a transaction between persons subject to VAT, the transitional arrangements will take the following form:

- The delivery of goods to another community country will be exempt from VAT and

- the purchase of goods in the country of destination will be subject to VAT, with the tax being payable by the purchaser.

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13 See Frankfurter Allgemeine Zeitung of July 29, 1992, p. 13, on the compromise of the Member States on the standard tax rate; Van Thiel, Removal of Indirect Tax Barriers to a Single European Market, VAT Monitor 1990, p. 17, 23.

14 EC Concil Directive of December 16, 1991, supplementing the common system of value-added tax, Official Journal No. L 376/1 of December 31, 1991; Schwarz, Die umsatzsteuerliche Übergangsregelung für den Europäischen Binnenmarkt ab 01.01.1993, Institut für Ausländisches und Internationales Finanz- und Steuerwesen, Hefte zur internationalen Besteuerung, Heft 82; Mennel, Die Umsatzsteuer-Harmonisierung in der Europäischen Gemeinschaft, Schriften zum Umsatzsteuerrecht Band 5, p. 20, 28.

With regard to no commercial purchases, the new arrangement would allow complete freedom for individuals to purchase goods in whichever Member State they choose, with such goods being taxed according to the conditions applicable in the state of purchase.[15]

During the transitional period, three special sets of arrangements will apply for the following areas:[16]

- New private vehicles will be taxed in the country of destination, where such vehicles will be registered.

- Mail order business is subject to tax arrangements under the principle of destination of the goods; but the tax at destination rule would only apply to companies whose mail order-trade with another country in the community exceeds 100,000 ECU per year.

- Non-taxable institutions and exempt persons such as banks, insurance companies and public administrations would be permitted to purchase goods in other Member States while paying the rate of VAT applicable in the country of purchase, as long as such purchases do not exceed a certain threshold.

These proposals are backed by another proposal concerning administrative cooperation in the field of indirect taxation. The Commission has laid down three primary conditions for increasing the exchange of information between the various tax administrations:

- The first condition is based on strengthening exchanges of information.

- The second condition is that EEC Member States be informed of all tax legislation developments in each Member State.

- The third condition refers to another concept. If one national fiscal authority has any doubts about a particular operation, it would be required to inform its counterpart in another EEC Member State of that operation spontaneously, without even having been any request therefore.[17]

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15 Howard M. Liebman / Russell M. Patten, Review of EC Tax Developments, European Taxation 1991, p. 364, 367.

16 After December 31, 1992, a transitional regime will apply for four years, Official Journal No. L 376/1,5: Title XVI a Art. 28 a to Art. 28 l of December 31, 1991.

17 Howard M. Liebman / Russel M. Platten, Review of EC Tax developments, European Taxation 1991, 364, 368.

4. Harmonization of Direct Taxes

Whereas harmonization of indirect taxes is explicitly provided for in Art. 99 of the Treaty, there is no such explicit reference in the Treaty to the possible goal of harmonizing direct taxes.

Nevertheless, the Treaty requires the removal of all restrictions on the movement of capital within the community (Art. 67 of the Treaty), on the freedom of establishment of firms (Art. 52 of the Treaty) and on the approximation of laws which directly and adversely affect

- the establishment or functioning of the Common Market (Art. 100 of the Treaty) or

- create distortions in the "conditions of competition" (Art. 101 of the Treaty).

The Treaty furthermore requires the non-discriminatory treatment with regard to the participation in the capital of companies and firms within the meaning of Art. 58 of the Treaty; this article also requires that companies and firms from other Member States be treated in the same way as individuals who are nationals of the Member States.

In the field of direct taxes on profits, capital, wealth and on income, progress was made during the past two years especially with respect to the problem of international double taxation.

This progress involves three proposals of the EEC:

- the Parent/Subsidiary Directive, aimed at eliminating the double taxation of dividents;[18]

- the Arbitration Procedure Convention, designed to eliminate the double taxation resulting from adjustments in transfer-pricing[19] and

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18 Ref. EC Council Directive - "Parent-Subsidiary Directive" - Official Journal No. L 225 p. 6 of August 20, 1990.

19 Convention on the elimination of double taxation in connection with the adjustment of Transfers of profits between associated enterprises (the Arbitration Procedure), EC Council Convention No. 90/463, Official Journal No. 11/225 of August 8, 1990, p. 10.

- the Merger's Directive providing for any capital gains arising from a merger or a similar operation to be taxed only upon realization.[20]

Furthermore, in November 1990, the Commission submitted two additional draft directives to the Council:

- The Interest and Royalties Directive, involving the abolition of withholding taxes on such payments within groups of companies within a Member State and across the border.

- The Foreign Losses Directive, enabling community enterprises and groups of companies to offset losses incurred as a result of transport activities.[21]

Notwithstanding this progress, a number of potential tax obstacles remain to the realization of the full benefits from the completion of a single internal market between now and the end of 1992.

From the German point of view, the national trade tax, capital tax and the taxes on individual and corporate income have to be considered.

5. Trade Tax and Capital Tax

The trade tax and capital tax are under dispute in Germany. They are a rather constant burden even if profits decrease. This is why the capital tax and the trade tax on capital is suspended in the former GDR from January 1, 1991 to December 31, 1994.

5.1 The Trade Tax

The Federal Republic of Germany levies a direct tax on trade through two instruments:

- the trade tax on income from national sources and

- the trade tax on capital employed within Germany.

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20 Ref. EC "Merger Directive". EC Council Directive No. 40/435, Official Journal No. L 225 of August 20, 1990, p. 6 of July 23, 1990 (90/434 EEC).

21 Ref. EC Proposal for a Council Directive as described above, Official Journal No. C 53 of February 28, 1991, p. 26 and 30.

The yield of these taxes - 41,7 billion Deutschmarks expected in 1992[22] - is with the municipalities, subject, however, to a rather complicated system of tax allocations.

The taxable base is the business income and business capital. The business income for the trade tax is equal to the profit shown on the income tax balance sheet, subject to certain adjustments such addition of 50 % of the interest paid for long term bank loans. The business capital for the trade tax is determined according to the provisions of the Valuation Law. The values assessed under the Valuation Law of a business are going concern values, and the taxable base is the total sum of the value of assets minus the total sum of certain debts incurred; this taxable base is e.g. increased by 50 % of the amounts of long term debts.

The rate is calculated by applying the multiplier to the amount which is assessed by applying the basic federal rate. The basic federal rate is 5 % of business income and 0.2 % of business capital.

The tax rate varies considerably from one location to another due to different multipliers applied by the municipalities. On average, the trade tax is between 12 % and 25 % of taxable income for - individual and corporate - income tax purposes.

Similar taxes are established in France, Italy, Luxembourg, Portugal and Spain.[23]

5.2 The Capital Tax

Germany levies a capital tax, the yield of which shall amount to 6,8 billion Deutschmarks in 1992.

Resident corporations and individuals are taxed on their worldwide net assets. Non-resident individuals and companies are subject to the capital tax only on certain assets situated in Germany.

The tax base is the value of the net assets which has to be determined pursuant to the provisions of the Valuation Law. In general, business assets are valued at their going concern value. The interest in affiliated corporations is tax exempt when the other corporation has a participation of 10 % or more in such affiliated company.

22 Finanzbericht 1992, p. 211.

23 Reference is made to Attachment 2 describing the trade tax levied by the Member States at present. Five out of twelve Member States do not levy any trade tax at all, while the German charge on income from business through trade tax is by far the highest within the EEC.

The net worth of business assets employed by corporations is double taxed. The corporation is subject to the capital tax with its assets employed, and the government levies the capital tax on the shares issued by such company at the shareholders' level as well.

The tax rate is 0.6 % for corporations and 0.5 % for individuals.

Only some Member States levy a tax on net worth. Luxemburg has established a system similar to the German concept; business assets are included in the taxable base. Greece is taxing real estate only belonging to corporations and/or to individuals notwithstanding whether the real estate is a private or a business asset.

Denmark, France, Ireland, The Netherlands and Spain levy a capital tax only from individuals. It is obvious that these countries treat assets of corporations carrying on business with consideration and indulgence.[24]

5.3 Arguments against the Trade Tax and the Capital Tax

The trade tax as well as the capital tax are elements of the cost of capital. They adversely affect decisions on international investment within the Member States. They are reasons of tax distortions on investments in Germany. Both burdens are costs of goods and services which are unknown in most of the other Member States.

The EEC has not yet approached to coordinate these taxes although they distort investment decisions.

The national governments levying these taxes discriminate their own economy, which is beyond the control of the EEC, but not for reasons of nationality.[25] Furthermore, there is still doubt whether or not the burden on prices for goods and services is material enough, so that the Commission or the Council should interfere under the Treaty.

The "Report of the Committee of Independent Experts on Company Taxation" published recently, recommends that Member States having such taxes should replace them by an on-

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24 Reference is made to Attachment 3 informing on the Member States which levy a capital tax on the tax rate as well. Out of 12 Member States three do not levy any capital tax at all, while others charge individuals only, so that capital employed for business purposes is exempt. Denmark and Germany charge capital devoted for business purposes.

25 Art. 7 of the Treaty is therefore not violated through these taxes, for general remarks see Grabitz, Kommentar zum EWG-Vertrag, Art. 7, Note 14.

profits tax levied on the same basis as the central government income tax.[26] This proposal relates to local business taxes, but the reason for the recommendation of this Committee is as well applicable versus the capital tax.

6. Income Tax on Individuals

Income tax on individuals is a direct charge the harmonization of which is subject to Art. 100 of the Treaty. The income tax system has to be coordinated as far as it otherwise prevents the establishment of an internal common market and perpetuates restrictions on the four freedoms.

In Germany, many businesses, including some very large ones, are unincorporated and carried on by individuals and their partnerships - different from the economic structure of other Member States where corporations prevail as legal instruments for business activities. This is the reason why German entrepreneurs do not only look for the harmonization of the corporate income tax, but also of the individual income tax.

The yield of the individual income tax shall amount to 291,450 billion Deutschmarks in 1992; individual income tax from profits should contribute 40,7 billion Deutschmarks to these revenues.[27]

6.1 Liability to Individual Income Tax

Residents are liable to income tax on their worldwide income. Non-residents are generally liable to this tax only on certain German source income.[28]

Like all the other tax systems of the Member States, an individual is, independent of his nationality, a resident of a country, if his domicile or habitual place of abode is within the country.

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26 "Ruding Report" 1992, p. 219.

27 Finanzbericht 1992, p. 211.

28 Krause/Laule/Mennel/Mössner/Runge/Viegener, Principles of German Tax Law, International Fiscal Association, 1981, p. 15, 55.

6.2 The Taxable Income

The taxable base in respect of the worldwide income are the following categories:

- agriculture and forestry
- trade or business
- independent personal services
- employment
- investment of capital
- rent from immovable property or certain tangible movable property and royalties and
- other income like speculative gains, income of a recurring nature etc.

Revenues from these categories are integrated into the taxable income.

Income from agriculture and forestry, trade business and independent personal services has relevance under Art. 100. With respect to these income categories, profit is the difference between the networth of the enterprise at the end of the business year and that at the end of the last preceding business year. The commercial accounts produced for financial reporting purposes form the starting-point to compute the taxable income.

The income tax law includes a sophisticated system of how to evaluate assets, stock etc.[29]

Business assets may be valued at their cost of acquisition or manufacture or at a going concern value. Stock may be valued at its cost of acquisition or manufacture as well or at the going concern value, whichever is lower.

The standard systems of depreciation are straight line method or the declining balance method. The depreciable base of a business asset acquired for consideration or produced for the business, is its cost.[30]

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29 Krause/Laule/Mennel/Mössner/Runge/Viegener, Principles of German Tax Law, International Fiscal Association 1981, p. 17 to 23.

30 Reference is made to Attachment 4, "Typical depreciation rates on industrual buildings and machinery" from the "Ruding Report", p. 179.

For certain liabilities or anticipated losses provisions may be set up, thereby reducing taxable income in the year of creation. Provisions may be made for certain future pension payments to employees, liabilities on surety obligations, warranties, damage claims, patent infringement, litigation expenses etc. Such provisions may not exceed the going concern value of the liability and the reflected provision in the commercial balance sheet.[31]

Business expenses are deductible when the business is the cause for such an expense; the concept is rather broad and business expenses are charges related to cars, entertainment, commissions, executive remuneration and headquarters expenses, etc.

6.3 Deduction of Losses

Losses accrued can be compensated in the form of a carry-back and/or a carry-forward with respect to all types of individual income. Losses must be compensated first by carrying them back. The carried back losses are deductible up to 10 million Deutschmark. For further losses an unlimited carry-forward has been introduced by 1990.[32]

The deduction of certain losses is limited as far as a negative capital account will arise or an existing one will be increased; the "at risk rule" applie s. The share of the losses assigned to a limited partner or a limited partnership cannot be set off by him against income deriving from other categories. If the losses cannot be set off in the current assessment period, they will diminish the profits of the limited partner in later assessment periods insofar as they derive from his participation in the limited partnership.

6.4 Capital Gains

Capital gains deriving during the course of a business are treated as ordinary business income; capital losses can be deducted as ordinary losses. For capital gains, the income tax rates of individuals will be reduced by up to one half with respect to income defined as extraordinary income, applicable for an amount not in excess of 30 million Deutschmark. Extraordinary income includes

31 Reference is made to Attachment 5 with a review of the main tax deductible provisions; as to this survey, Germany accepts expenditures to build up such provisions if the event occurs during the business. The table was taken over from the "Ruding Report", p. 247.

32 The "Ruding Report" contains a table on the carry-over of trading losses on p. 242 which is attached to this paper as Attachment 6. As to this schedule, international trends indicate an unlimited carry-forward of losses and a carry-back of losses limited timewise. This coordination of the treatment of losses is likely to be introduced by national legislation.

- capital gains realized from the sale of a business or part of a business or from the sale of a participation held by a partner or a general partner of a limited partnership with shares,

- capital gains realized from the sale of more than 1 % of the shares in a corporation in which the shareholder owns directly or indirectly a substantial interest which is more than 25 % of the share capital and capital gains which are realized from the sale of assets which are used to render independent personal services or from the sale of an interest in a partnership rendering independent personal services.

6.5 Partnerships

Partnerships are taxed according to the principle of transparency: profits are taxed in the hands of the partners in proportion to their share in the business, even when they have not actually received the corresponding amount of the profits. Partnership profits are thus taxed in a very similar way like those of sole proprietorships. This rule applies in nearly all Member States. However, in Belgium, Spain and Portugal, commercial or industrial partnerships are in practice liable for corporation tax; in France, partnerships may opt to pay corporation tax.

6.6 Tax Scales

The German individual income tax rates are 19 % for an annual income of 5,617.-- Deutschmarks up to 53 % for an income of 120,04 2.-- Deutschmarks upwards. Married persons are assessed jointly so that the marginal rates are applicable on twice of the income of a single person. In addition, the 7,15 % solidarity surcharge must be added for 1991 and 1992.[33]

The tax burden on individual income from business must take into account

- the trade tax,

- the capital tax,

- the income tax and solidarity surcharge and

33 Reference is made to Attachment 7 showing the tax rates on individual income of the Member States.

- a churchtax which amounts to ca. 4.5 % of the income.

Summing up these items, the tax burden on individual income may easily achieve between 65 to 75 % of the annual income.

6.7 Trends

The European Communities have not yet enacted special rules concerning the income tax; the Council, however, adopted directives concerning corporate income tax which will amend also the individual income tax in Germany.

7. Corporate Income Tax

The European Communities have defined a new concept of economic integration in the late 80's. Priority has now been given to coordination and mutual approximation of Member States' tax systems rather than a systematic harmonization imposed at the EEC level. This advanced concept developed under the Principle of Subsidiarity according to the Treaty means that the community as mentioned above can intervene only if the objectives of the Treaty can be better achieved by the community than by the Member States acting separately.

The work of the European Communities in coordinating tax systems is in principle devoted to the proper functioning of the Common Market and the forthcoming Economic Monetary Union. Tax differences should no longer distort competition and investment location across the borders of the Member States.

I will render a review on the German corporate income tax and consider influences to be expected from actions of the EEC.

The yield of the German corporate income tax system is estimated to be 31,3 billion Deutschmarks in 1992[34].

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34 Finanzbericht 1992, p. 211.

7.1 The Corporate Income Tax System

The German corporate income tax system is a total imputation system which completely eliminates the economic double taxation of distributed corporate profits. Distributed profits are taxed in the hands of an individual resident shareholder and the imputed tax is credited against the recipient's personal tax liability. The solidarity surcharge is not eligible for the imputation credit.

7.2 Liability to Corporation Tax

The tax is levied on the various types of entities listed in the corporation tax law such as stock corporations and limited liability companies; partnerships are not taxed as separate entitites, the partners are being taxed individually on their share of profit. The German system does not offer an option for partnerships in favour of corporate income tax instead of individual income tax like other Member States, nor does it offer an option for the limited liability company to be taxed under the indiviudal income tax scheme which France permits. The tax concept for partnerships and for limited liability companies differs from Member State to Member State. The "Ruding Report" recommends the establishment of rules which would permit unincorporated enterprises the option of being taxed as if they were companies,[35] and small companies to be determined by statute shall be permitted to the option of being taxed under the individual income tax law of the Member State where such small corporation has its central place of management.

A taxable person will be charged on worldwide income when it has its legal seat or place of central management within the country. This concept is applied through all the other Member States independently from requirements of the European Communities.

7.3 Taxable Income

Corporate income is the total amount of income after deduction of business expenses. In general, capital gains and capital losses are included in ordinary taxable income; capital gains however on the alienation of certain assets which are replaced with assets of a similar kind may be rolled over.[36]

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35 See p. 219.

36 Reference is made to Attachment 8 "Treatment of corporate capital gains". This table shows the broad variety of how to tax capital gains in the Member States and other countries.

The tax base for the individual income tax and for the corporate income tax is identical; the corporate tax law refers to the rules on tax accounting implemented in the individual income tax law.[37]

Differences in the rules of the Member States to determine the level of taxable profits create distortions which are incompatible with the efficient operation of the internal market.[38]

7.4 Trends of the EEC for the Determination of Corporate Income

The Commission had issued a preliminary draft directive on harmonizing the rules for the determination of the corporate taxable base in June 1988; however, the Commission subsequently withdrew the draft directive in May 1989. The Report of the Committee of Independent Experts on Company Taxation came forward with recommendations for further EEC action regarding the taxable base.[39]

Which are the merits of such action to be based upon? As to the rules already enacted in most of the Member States, the commercial accounts produced for financial reporting purposes should be the start for the computation of taxable income in all Member States. The financial statements and evaluation system of the three Accounting Directives should apply. The balance sheets drawn up in accordance with the Rules for Financial Reporting Purposes thus should determine the items for book entry purposes and form the basis for evaluating assets, liabilities and the taxable profit; the balance sheet regulations under commercial law are recognized for tax purposes. Divergencies should only take place insofar as the tax law explicitly provides. Through the standard and internationally accepted accounting principles in all of the Member States, taxable profits should be defined in determining revenues as well as expenses such as depreciation, reserves, provisions or headquarters costs, etc.

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37 Reference is made to 6.2 and p. 35 to 37. The determination of the profit proceeds on the basis of the commercial balance sheet. Special balance sheet regulations for various forms of corporations must also be considered for tax purposes. The corporation tax law contains special provisions to restrict the deductibility of certain operational expenditures such as the capital tax, the turnover tax relating to goods of the corporation which were privately consumed and payments of any kind to members of a supervisory board.

38 "Ruding Report", p. 211.

39 "Ruding Report", p. 211, 212.

7.5 Tax Losses

Tax losses are treated equally for German individual as well as corporate income tax. All Member States accept carry-forward principle, subject to various conditions; these conditions result in unequal treatment on the take-over or reorganization of business. It is the common understanding to harmonize the carry-forward conditions in all Member States. Germany has an unlimited loss carry-forward enacted.[40]

With regard to losses carried back, there is much less unanimity among the Member States. The existing differences may not result in a general distortion of competition but may lead to significant unequal treatment in very specific cases such as mergers and acquisitions of businesses. These considerations tie in with other proposals on loss carry-over between parent and subsidiary.

7.6 Capital Gains

With their capital gains and their impact on the taxable base the rules of the Member States vary widely in the approach to their taxation, resulting in considerable differences in burden and timing. It is clear that the taxation of capital gains is a major factor in determining the burden of taxation on business enterprises in Germany. Capital gains are ordinary income as mentioned above.[41]

The report of the Committee of Independent Experts on Company Taxation recommends that the Commission enacts by way of directive a proposal to the effect that capital gains on depreciable or non-depreciable fixed assets should not, upon reinvestment within a fixed period of time, be taxed but there would be a roll-over of the tax base of the old assets into the new assets. With regard to financial assets, the Committee proposes a directive to the effect that upon reinvestment within a fixed period of time, either in fixed assets or in another controlling shareholding capital gains realized on the disposal of a controlling shareholding should not be taxed but there would be a roll-over in the tax base of the old assets into the new assets. In the absence of reinvestment, capital gains should be taxed, a correction however for inflation should apply to capital gains realized on fixed assets, in controlling shareholders as well as to all financial investments that do not constitute cash deposits or other short

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40 See Attachment 6, Note 19.

41 See Attachment 8, Note 23.

term monetary assets.[42]

These proposals are sound incentives for investments in business and employment.

7.7 Integrated Companies

A German group of companies may be treated for tax purposes as if the companies formed one single unit; their profits and losses are pooled in the hands of the controlling company. Therefore, losses of each company can be set off against profits realized within the group. The effect of the treatment is that the parent company becomes liable for corporate income tax on the pooled profits.

To qualify for group taxation specific conditions must be fulfilled so that the daughter company will be considered as an integrated department of the parent company.

Cross-border grouping is not permitted, since the parent as well as the daughter company have to be registered and have their place of central management within Germany.

When a company receives dividends from another domestic company, the net dividend received, grossed up in respect of both the withholding tax and the corporate income tax on dividends, constitute taxable income in the hands of the shareholder. The withholding tax as well as the corporate income tax on distributed dividends can be credited by resident shareholders against their own tax liability.

All transactions between related companies must be carried out in accordance with the arm's length principle. If, therefore, the transfer prices are not in line with the market prices, either hidden distributions of profit or hidden contributions to capital will be assumed. This assumption entitles the tax administration to adjust the profits according to national tax regulations based on OECD models.

Within the Member States, the approach to taxation of groups is based on the legal structure of the businesses involved without regard to the economic ties between them. Several Member States apply a system for tax consolidation whereby all parts of the domestic group are taxed as a single unit. There are other variations which achieve some of the effects of consolidation, such as the transfer of losses between the members of the group. In most

42 "Ruding Report", p. 217. As to the international trend, an increasing number of tax systems avoid taxes upon earnings generated through inflation; with respect to inventories see Attachment 9 of the "Ruding Report, p. 181.

cases, the benefits of these arrangements depend on the parent having a substantial holding in the subsidiary company and/or upon authorization by the tax authorities. The system usually is optional.

Member States often have different rules for handling the profits of foreign permanent establishments compared with wholly domestic business. The problem of loss relief does not usually arise in Member States which exempt profits of a foreign permanent establishment or a foreign daughter company do not in principle take into account any losses incurred; if they do so, then they subsequently tax any profits made by the perman ent establishment up to the amount previously deducted (Belgium, Germany and The Netherlands).

Denmark, France, The Netherlands and Spain have specific provisions with respect to foreign subsidiaries through the consolidation of subsidiaries for tax purposes.

In November 1990, the Commission introduced a proposal[43] allowing Member States the choice of two methods for relieving the losses of foreign permanent establishments and affiliated companies against domestic profits of enterprises: the credit method or the method of deducting losses and reincorporating subsequent profits. The Member States, however, would also be allowed to introduce other methods such as consolidation.

These proposals shall support the creation of an internal common market; profits and losses of foreign subsidiaries or foreign permanent establishments situated in one of the Member States shall be treated taxwise as if occured in the jurisdiction the parent is registered and has its place of central management.

7.8 Mergers and Acquisitions

In Germany, mergers and acquisitions may be undertaken under favourable fiscal arrangements between companies, partnerships and a business carried on by sole proprietorship. However, each of the persons involved has to have its place of registration, its seat of central management or its residence within Germany; the law provides for the deferral of taxation and capital gains within the country.

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43 Proposal for a Council Directive concerning arrangements for the taking into account by enterprises of the losses of their permanent establishments and subsidaries situated in other Member States, Official Journal No. 53 of Febr. 28, 1991, p. 30; Liebman/Patten, Review of EC Tax Developments, European Taxation 1991, 364, 366.

7.9 The Tax Rate

The German corporate tax rate is 50 % computed on retained earnings; in addition, the solidarity surcharge is due. The refund equals 14/50 of the net distribution. The solidarity surcharge is not eligible for the imputation credits.[44]

If the company distributes profits, irrespective of whether the distributions are made out of current profits or out of reserves, part of the corporate income tax is refunded. The effective rate on any profit distribution is 36 %. Where the tax rate is 50 % on undistributed profits, the refund equals 14/50 of the net distribution.

8. European Communities Taxation of Corporation

The principal differences in the taxation of a business income between Member States relate to the nature of the corporation tax system and statutory tax rates. This report already covered the definition of the tax base.

8.1 Corporation Tax Systems

Luxemburg and The Netherlands operate classical corporation tax systems, under which profits distributed in the form of dividends are fully taxed twice, once at the corporate level and again at the shareholders' level. The other 10 Member States provide varying degrees of relief of such double taxation. Imputation credits are granted in Germany, France, Italy, Ireland and the United Kingdom, with France, Germany and Italy providing a full credit for corporation taxes actually paid, while Belgium, Denmark and Portugal levy reduced personal tax rates on dividend receipts.

The different corporation tax systems constitute a source of discrimination against cross-border investment flows. Such discrimination tends to fragment capital markets in the community. The European Communities were likely to recommend the harmonization of systems of company taxation, withholding taxes on dividends through the centralized harmonization of tax systems in the community; half of the corporate income tax on di-

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44 See Attachment 10 "Current Corporate Income Tax Rates" showing the broad variety of rates on corporate income applied through the Member States. The table was developed from the European Community's Taxation of Corporations, Supplementary Service to European Taxation, Section A, No. 2, February 1992.

vidends distributed should be credited on the level of the recipient. This proposal was withdrawn by the Commission in 1990.

The Report of the Committee of Independent Experts on Company Taxation recommends insofar that the Commission and the Member States determine the most appropriate common corporation tax system for the community avoiding discrimination against cross-border investment flows.[45]

The existing discrimination of dividends distributed from profits earned in another Member State shall be removed. Member States which apply imputation taxes on the distribution of profits earned in another State, should be obliged on a reciprocal basis to allow such tax to be reduced by corporate income tax paid in the other Member State in respect of dividends remitted by a subsidiary or profits earned by a permanent establishment. Member States with various forms of tax relief for dividends received by domestic shareholders from domestic companies should be obliged on reciprocal basis to provide equivalent relief of dividends received by domestic shareholders directly from companies in other Member States .

These proposals if accepted would let imputation systems be applicable across the border and not only within a national tax jurisdiction.

8.2 Tax Rates

Furthermore, it is desirable to establish a minimum degree of harmonization with respect to the statutory tax rate. Following the EEC approach with the VAT, minimum rates should be set at a level that provides Member States with the freedom to achieve the greatest possible degree of domestic tax neutrality without affecting their existing tax revenues.[46]

Such minimum statutory corporation tax rate could be 30 % in all Member States for all companies.[47]

Local income taxes like the German trade tax on income and capital should either be abolished or taken into account when fixing the statutory corporation tax rates.

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45 "Ruding Report", p. 209.

46 With respect to the existing tax revenues Attachment 10.

47 This is the proposal of the "Ruding Report", p. 210.

The maximum statutory corporate tax rate should be 40 % taking into account that already today most of the Member States levy 40 % or even less corporate income tax.

Comparing the highest tax rate on individual income tax and today's corporate income tax, the German tax system is neutral versus the legal form of how to carry on business; individual income tax and corporate income tax on retained earnings are very near together.[48]

Within a system, where the corporate income tax is only 40 % or even lower, the span between the highest tax rate on individual income and the rate on corporate income is increasing; it is to be expected that German businesses today run by sole proprietorships or by a partnership will then be transformed into a corporation.

The EEC-proposal on mergers and reorganization of companies provides for deferral of taxation on capital gains on defined cross-border mergers or reorganizations within the EEC.[49] The exchange of shares together with a related cash payment not exceeding 10 % of the nominal value of the shares will be tax privileged, even if across the border. Assets transferred across the border and contributed in kind to another company in exchange for shares may be completed on the basis of existing book values not realizing hidden reserves; the same applies to mergers and to the division of companies in which one or more companies being dissolved without going into liquidation, to the transfer of assets and liabilities to another existing or new company, in an exchange of shares issued.

The Parent/Subsidiary Directive aims at reducing the differences between taxation rules for nationally organized groups of companies and taxation rules for EC-wide groups.[50] The Member State of the parent company

- either refrains from taxing the profits of a subsidiary that is resident in another Member State

- or authorizes the parent company to deduct from the amount of tax due the corporation tax paid by the subsidiary in the other Member State.

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48 Reference is made to Attachment 11. The table shows the difference between top central-government marginal personal tax rates on earnings and corporate tax rate on retentions.

49 See EC Merger Directive of July 23, 1990, EC Council Directive No. 90/434, Official Journal No. 225 of August 20, 1990, p. 1.

50 See EC "Parent/Subsidiary" Council Directive No. 90/435, Official Journal No. L 225 of August 20, 1990, p. 6.

Profit distributions by the subsidiary to the parent company across the border shall be exempt from withholding tax which, for a transitional period, will only be permitted for Germany, Greece and Portugal. The common system of taxation applicable to parent companies and their subsidiaries in different Member States requires a share in the daughter company of at least 25 %.

The Convention on the Elimination of Double Taxation - the Arbitration Procedure[51] - provides for a cooperation and arbitration procedure to be utilized when Member States cannot themselves reach agreement as to the acquitable elimination of double taxation arising from an adjustment of profits between companies in two or more Member States.

If the tax authorities fail to reach an agreement which eliminates double taxation, the case must be presented to a specially formed arbitration commission, the decision of which is binding. Such arbitration commissions will consist of representatives of the respective tax authorities and a number of independent experts. The tax payer takes part in the procedure and can present his views on the case. This procedure is improving the mechanisms existing under the double taxation agreements.[52]

Two further proposals of the EEC Commission should be mentioned.

The EC Commission has submitted a draft directive on a common system of taxation applicable to interest and royalty payments made between parent companies and subsidiaries in different Member States.[53] Withholding taxes on such payments should be abolished. The ability to generate tax free royalty streams may warrant a new look at maximizing licensing opportunities, perhaps based on new product development, or for the right to use trademarks or tradenames. The company loans or royalty arrangements should prove even more tax-efficient than dividend flows arising from capital contributions; interest and royalty payments will be deductible, while dividends will be distributed from net income after corporate income tax.

Another draft directive deals with arrangements for the taking into account by enterprises of the losses of their permanent establishments and subsidiaries situated in other Member Sta-

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51 EC Council Convention No. 90/463, EC Official Journal No. L 225 of August 8, 1990, p. 10.

52 Vogel, On Double Taxation Convention, 1991, Art. 25, Note 32: "Only representatives of the authorities of those two States whose taxes are involved may take part in a mutual agreement procedure"; Note 76: "The competent authorities are under no obligatioin to reach agreement in the course of a mutual agreement procedure".

53 EC Official Journal, No. C 53 of February 28, 1991, p. 26.

tes.[54] On the current law, such losses are usually not consolidated. With regards to subsidiaries, the directive requires that the EEC-based parents deduct the foreign branch losses with their subsequent recapture. In order to qualify for the regime, the parent company must hold at least 75 % of the shares and a majority in the voting rights of the EEC subsidiaries in question. The individual member State may choose to apply a lower ownership threshold which is necessary for investments in other Member States with respect to their start-up losses.

This concept was developed on the IFA-Congress 1979 at Copenhagen and backed by the resolution; this all based upon my general report on the treatment of losses.[55]

9. Summary

The EC Commission does no longer strive to harmonize for the sake of harmonization but rather to act where community-wide measures were deemed indispensible. It is, in other words, the Principle of Subsidiarity which must govern the relations between the Commission and the Member States, an approach which the Commission also used in tackling the problems of indirect taxation, allowing the abolition of intra-community border control. I agree with this statement of Madame Scrivener[56] and I believe that the coordination of tax systems of the national tax systems will create a harmonization at a later stage and promote the development of economic activities, a continuous and balanced expansion, an increased stability, an accelerated raising of the standard of living and closer relations between the Member States as Art. 2 of the Treaty states.

54 EC Official Journal No. C/53 of February 28, 1991, p. 30.

55 Laule, General Report on: The effect of losses in one country on the income tax treatment in other countries of an enterprise or of associated enterprises engaged in international activities, Cahiers de Droit Fiscal International, LXIVb 1979, p. 71, 94.

56 Scrivener, Harmonization of Tax Law within the Community, European Taxation 1990, 355.

Attachments

No.	1	Rates allowed to apply in addition to normal VAT
No.	2	Trade Tax
No.	3	Capital Tax
No.	4	Typical depreciation rates on industrial buildings and machinery
No.	5	Main tax deductible provisions
No.	6	Carry-over of trading losses
No.	7	Individual income tax rates
No.	8	Treatment of corporate capital gains
No.	9	The tax treatment of inflationary gains in the value of inventories
No.	10	Current corporate income tax rates
No.	11	Difference between top central-government marginal personal tax rates on earnings and corporate tax rate on retentions

Attachment 1

Rates allowed to apply in addition to normal VAT

Under the Sixth Directive, Member States are allowed to apply "reduced" rates (in general for basic needs) and "increased" rates (normally for luxury goods or services), in addition to the normal VAT rate.

At present the following VAT rates apply within the EC:

Country		Rate (%)
Belgium	- normal rate	19,5
	- reduced rate	12
	- basic necessities	6
	- gold	1
Denmark	- uniform rate	25
	- reduced rate	0
France	- general rate	18,6
	- reduced rate	5,5
	- increased rate	22
Germany (Fed.Rep.)	- normal rate	14
	- reduced rate	7
Greece	- normal rate	18
	- reduced rate	8
	- books/newspapers	4
	- increased rate	36
Ireland	- normal rate	21
	- reduced rate	10
		12,5
Italy	- normal rate	19
	- reduced rate	9
		4
	- increased rate	38
Luxembourg	- normal rate	15
	- reduced rate	6
		3
Netherlands	- normal rate	18,5
	- reduced rate	6
Portugal	- normal rate	17
	- reduced rate	8
		0
	- increased rate	30
Spain	- normal rate	13
	- reduced rate	6
	- increased rate	28
United Kingdom	- normal rate	17,5
	- reduced rate	0

Attachment 2

TRADE TAX

Country	Taxable Base	Taxrate
Belgium	-	-
Denmark	income of individuals	22,6 - 32,1 %
France	rental value and 18 % of payroll	3,5 %
Germany	business income and business capital	12,0 - 25,0 %
Greece	-	-
Ireland	-	-
Italy	corporate income from domestic sources	16,2 %
Luxembourg	business income and business capital	1,8 - 5,0 %
Netherlands	-	-
Portugal	corporate income	10,0 %
Spain	minimum quota	15,0 % of income
United Kingdom	-	-

Attachment 3

CAPITAL TAX

Country	Taxable Base	Taxrate
Belgium	-	-
Denmark	net worth of individuals capital tax of corporations	1,2 %
France	net worth of individuals no net worth for corporations	up to 1,5 %
Germany	net worth of corporations and individuals	0,6 % 0,5 %
Greece	value of immovable property of corporations and of individuals	1,5 % up to 2,0 %
Ireland	real property of individuals	1,5 %
Italy	-	-
Luxembourg	net worth	0,5 %
Netherlands	net worth of individuals, the the assets of whom are situated in the country	0,8 %
Portugal	-	-
Spain	net worth of individuals	up to 2,5 %
United Kingdom	-	-

TABLE 8.12

Typical depreciation rates on industrial buildings and machinery[1]

	1980		1985		1991	
	Buildings	Machinery	Buildings	Machinery	Buildings	Machinery
Belgium	10%DB × 7 then 5%SL	40%DB × 2 then 20%SL	10%DB × 7 then 5%SL	40%DB × 2 then 20%SL	10%DB × 7 then 5%SL	40%DB × 2 then 20%SL
Denmark	6%SL × 10 then 2%SL	22.5% × 1 then 30%DB	6%SL × 10 then 2%SL	25% × 1 then 30%DB (indexed)	6%SL × 10 then 2%SL	30%DB
Germany	2%SL	20%DB × 5 then 10%SL	5%SL × 8 then 2.5%SL × 5 then 1.25%SL	20%DB × 5 then 10%	10%SL × 4 then 5%SL × 3 then 2.5%SL	30%DB × 4 then 10%SL
Greece					8%SL	20%SL
Spain	7.5%DB	20%DB	7.5%DB	20%DB	7.5%SL	20%DB
France	5%SL	27.8%DB × 7 then 11.1%SL	5%SL	27.8%DB × 7 then 11.1%SL	5%SL	35.7%DB × 5 then 5.5%SL
Ireland	100%	100%	100%	100%	50% × 1 then 4%SL	50% × 1 then 12.5%DB
Italy	7%SL	15.5%SL	7%SL	15.5%SL	5%SL	17.5%SL × 3 then 10%SL
Luxembourg	4%SL	20%SL	4%SL	20%SL	4%SL	30%DB × 2 then 20%SL
Netherlands	6.6%DB	25%DB × 3 then 12.5%SL	6.6%DB	25%DB × 3 then 12.5%SL	6.6%DB	25%DB × 3 then 12.5%SL
Portugal	4%SL	20%SL	4%SL	20%SL	5%SL	31.25%DB
UK	50% × 1 then 4%SL	100%	25% × 1 then 4%SL	50% × 1 then 25%DB	4%SL	25%DB
Japan	3.5%DB	23%DB × 9	3.5%DB	23%DB × 9	6.6%DB	30%DB × 9
Switzerland	8%DB	30%DB	8%DB	30%DB	8%DB	30%DB
USA	3.5%SL	18.8%DB × 2 then 12.5%SL	ACRS[2]	ACRS[2]	3.2%SL	28.6%DB × 3 then 9.1%SL

Key: SL: straight-line; DB: declining balance.
10%DB × 7 then 5%SL means 10% declining-balance depreciation for seven years followed by depreciation at 5% straight-line until the asset is fully depreciated.

1 These depreciation rates apply to the typical assets used in the calculations in this chapter (see Annex 4A) and so differ from the rates set out in Annex 3.

2 The accelerated cost recovery system in the USA during the mid-1980s involved complex depreciation provisions; typical straight-line depreciation rates for machinery were 8% in the first year, 14% in the second, 12% in the third, 10% for the next three years and 9% for the next four years. Industrial buildings might typically be depreciated at 6% for 10 years and 5% thereafter.

Source: Information provided to the Ruding Committee by national tax authorities.

TABLE 3A.10

Main tax deductible provisions

	Bad debts	Probable charges	Vacation pay	Inventory price Increase reserve	Retirement indemnity	Depreciation of securities
Belgium	Yes (limited)	Yes	Yes	No	No[1]	No
Denmark	Yes	No	Yes	No		No
Germany	Yes (limited)	Yes	Yes	Yes (limited)	Yes (conditional)	Yes
Greece	No	No	No	No	No	No
Spain	Yes (limited)	No	No	No	No	Yes
France	Yes	Yes (conditional)	Yes (conditional)	Yes (conditional)	No	Yes[2]
Ireland	Yes	Yes (conditional)	Yes	No	Yes (conditional)	No
Italy	Yes	No	Yes	No	No[3]	Yes
Luxembourg	Yes	Yes	Yes		Yes	
Netherlands	Yes	Yes	Yes	No	Yes (conditional)	No
Portugal	Yes (limited)	Yes (conditional)	Yes			
United Kingdom	Yes	Yes	Yes (conditional)	No	Yes (conditional)	No

1 Subject to certain conditions and limitations, contributions for complementary retirement benefits are deductible as ordinary business expenses.
2 Such provisions are treated as long-term capital taxes, deductible only from capital gains of the same kind liable to a reduced tax of 18%.
3 An allowance for dismissal or retirement calculated with a specific formula is deductible.

Source: Report of CNPF Working Group on corporate taxation and the single European market.

TABLE 3A.5

Carry-over of trading losses

	Carry-back: maximum number of years authorized	Carry-forward: maximum number of years authorized
Belgium[6]	—	No limit[6]
Denmark	—	5
Germany	2[1]	No limit
Greece	—	5
Spain	—	5
France	3[2]	5[5]
Ireland	1	No limit
Italy	—	5
Luxembourg	—	No limit
Netherlands	3	8[4]
Portugal	—	5
United Kingdom	3	No limit
Austria	—	7
Canada	3	7
Japan	1	5
Sweden	—	No limit
Switzerland	—	6[3]
United States	3	15

1 Amount limited to DM 10 000 000.
2 Under certain conditions.
3 As a rule, a tax period covers two years. A loss in one year is automatically carried over to the second year of the same period. In the case of federal taxes the loss incurred in one period may be carried forward for three periods.
4 Losses originating from the first six years of a company's existence are unlimited compensatable.
5 However, the amount of loss corresponding to the amount of depreciation may be carried forward indefinitely to later years.
6 However, the deduction of the trading losses may not exceed BFR 20 million a year. This limit will be applicable from assessment year 1992.

Sources: International Bureau of Fiscal Documentation (Member States), Coopers and Lybrand and others.

Attachment 7

INDIVIDUAL INCOME TAX RATES

Country	Taxrate
Belgium	25 % to 55 %
Denmark	22 % to 40 % (without judge tax and special income tax)
France	5 % to 56,8 % single, divorced, widow without dependants
Germany	19 % to 53 %
Greece	18 % to 50 %
Ireland	29 % to 52 %
Italy	10 % to 51 %
Luxembourg	10 % to 50 %
Netherlands	38,55 % to 60 %
Portugal	15 % to 40 %
Spain	20 % to 53 %
United Kingdom	25 % to 40 %

TABLE 3A.6

Treatment of corporate capital gains

	Taxed at corporation level	Taxed at special rate	Inflation adjusted	Tax deferred if reinvested
Belgium	Yes, assets held less than five years	More than five years: 19.5%[7,9]	No	Yes[8]
Denmark	Yes, shares held less than three years and real estate		No	No
Germany	Yes	No	No	Yes
Greece	Yes	20% partition of business 30% trade mark, goodwill	No	No
Spain	Yes	—	No	Yes[11]
France	Yes	Less than two years: 34% More than two years: 18% from 1.10.1991[1]	No	No
Ireland	Yes	Holding period rate[12] Less than three years: 50% Three to six years: 35% More than six years: 30%	Yes	Yes
Italy	Yes[10]	—	No	No
Luxembourg	Yes	—	No	Yes
Netherlands	Yes	—	No[6]	Yes
Portugal	Yes	—	Yes[2]	Yes[3]
United Kingdom	Yes	—	Yes	Yes
Austria	Yes		Yes (holding period at least 19 months)	No
Canada	75% of value		No	No
Japan	Yes[5]	—	No	No
Sweden	Yes[4]		No	No
Switzerland	Yes[5]	—	No	No
United States	Yes	—	No	No

1 If the net capital gains (82% of the gross amount) accounted for and maintained in a special reserve in the balance sheet, otherwise 34%.
2 For depreciation of assets within limits.
3 *Subject to two years time-limit.*
4 With respect to the special reserve provision, the effective taxed rate is 77% of the corporate tax rate.
5 Special rates for real estate.
6 *When determining the taxable profits made in a calender year* 1% of the corporate capital may be deducted (capital allowance meant as an adjustment for long-term structural inflation). This capital allowance only applies to income tax paying entrepreneurs.
7 This system is only applicable to gains related to certain shares held for more than five years.
8 *The taxation of capital gains from the alienation of tangible or intangible* fixed assets can, on condition of reinvestment, be allocated over several years in proportion to the depreciation of the assets in which the company has reinvested.
9 19.5% only on capital gains on stock, and on all assets if capital gain is realized during the liquidation of the company.
10 Deferral *over five years except for bonds and securities.*
11 Conditionally.
12 Capital gains from the sale of development land are chargeable to capital gains tax at special rates and not corporation tax.

Source: OECD.

TABLE 8.15

The tax treatment of inflationary gains in the value of inventories

	1980	1985	1991
Belgium	Unindexed	Unindexed	Unindexed
Denmark	Partially indexed	Partially indexed	Partially indexed
Germany	Indexed	Indexed	Indexed
Greece			Indexed
Spain	Unindexed	Unindexed	Unindexed
France	Unindexed	Unindexed	Unindexed
Ireland	Unindexed	Unindexed	Unindexed
Italy	Indexed	Indexed	Indexed
Luxembourg	Unindexed	Unindexed	Unindexed
Netherlands	Indexed	Indexed	Indexed
Portugal	Indexed	Indexed	Indexed
UK	Indexed	Unindexed	Unindexed
Canada	Unindexed	Unindexed	Unindexed
Japan	Indexed	Indexed	Indexed
Sweden	Partially indexed	Partially indexed	Unindexed
Switzerland	Indexed	Indexed	Indexed
USA	Indexed	Indexed	Indexed

Source: King and Fullerton (1984), Jörgensen (1992) and information provided to the Ruding Committee by national tax authorities.

Current Corporate Income Tax Rates

Below is a short overview of current corporate income tax rates in EC Member States. This information is subject, however, to the following qualifications:

1. only taxes levied by and for the account of the Central Government are mentioned (e.g. not the German business tax);
2. the normal tax rate does not necessarily apply to all income components;
3. certain types of corporate entities may be exempt from income taxation; and
4. the method of taxation applied to individual recipients of income from corporations (e.g. imputation systems) is not considered.

For more details see the country chapters in this book.

Country	*Rate (%)*
Belgium	
first 1,000,000 Bfrs.	28
next 2,600,000 Bfrs.	36
next 9,400,000 Bfrs.	41
excess over 13,000,000 Bfrs.	39
Denmark (1991)	38
France	34
Germany[1]	
retained income	50
distributed income	36
non-resident companies	46
Greece	
retained income	46
distributed income	0
Ireland (1991/92)	40
Italy	36
Luxembourg	33.33
Netherlands	
first 250,000 Dfl.	40
excess thereover	35
Portugal	36
Spain	35
United Kingdom (1991/92)	
until £ 250,000	25
next £ 1,000,000	35
excess over £ 1,250,000	33

Attachment 11

TABLE 8.8

Difference between top central-government marginal personal tax rates on earnings and corporate tax rate on retentions

	1980	1986	1990
Belgium	24	27	16
Denmark	2.6	−5	2[1]
Germany	0	0	3
Greece		14	4
Spain		33	20.7
France	10	15	22.8
Ireland	15	10[2]	13[2]
Italy	47	26	14
Luxembourg	17	17	23
Netherlands	26	30	25
Portugal	49.4	14	4
UK	8	20	6
Average[3]	19.9	15.4	12.9
(standard deviation)	(17.1)	(11.4)	(8.8)
Austria	0.5	0.5	11
Canada	0.6	−17.6	−12.7
Japan	23	24.6	0
Sweden	10	−2	−10
Switzerland	0	0	0
USA	19.8	10.5	−10.3

[1] Retained profits of unincorporated business normally taxed at corporate income tax rate in Denmark.
[2] Non-manufacturing industry.
[3] Average of 10 countries excluding Greece and Spain.

Source: See Tables 8.5 and 8.7.